



# **The Impact of Federal Regulations**

## on the Financial Services Industry

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# Executive Summary

The FDIC Quarterly Banking Profile (Fourth Quarter 2010) reported revenue growth for insured institutions as sluggish. The mere 1.6 percent revenue growth was the second-worst-year-over-year comparison in the past 16 years. While the downturn in the economy is the primary cause for the “sluggish” growth, another major factor, federal regulations, has also been significantly impacting financial institutions.

The Dodd-Frank Wall Street Reform and Consumer Protection Act is the most sweeping change to financial regulations in the United States since the Great Depression. This act has had a profound effect on the nation's financial services industry.

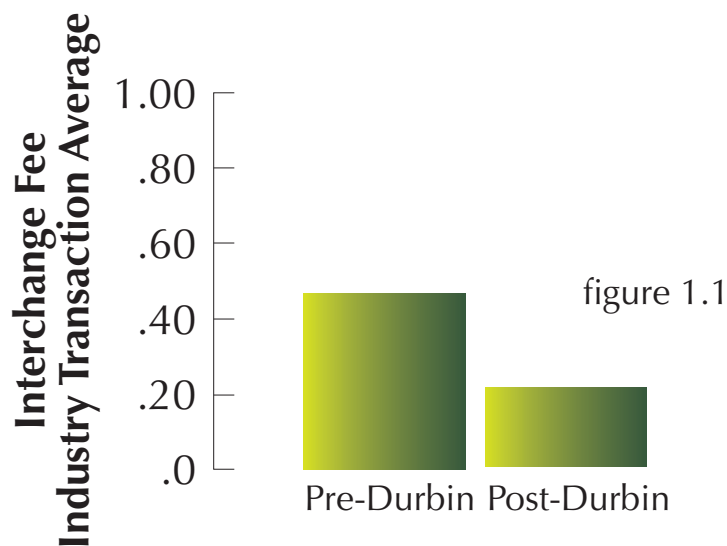
Revenue streams associated with debit card interchange fees and non-sufficient fund (NSF) fees are being significantly reduced as a direct result of the Durbin Amendment and Regulation E Section 205 from the Dodd-Frank Act. The resulting impacts on an institution's profitability are substantial. Included in this white paper are the bottom-line impacts that the Durbin Amendment and Regulation E Section 205 are having on banks and credit unions.

# Durbin Amendment

## Durbin Amendment (effective October 1, 2011)



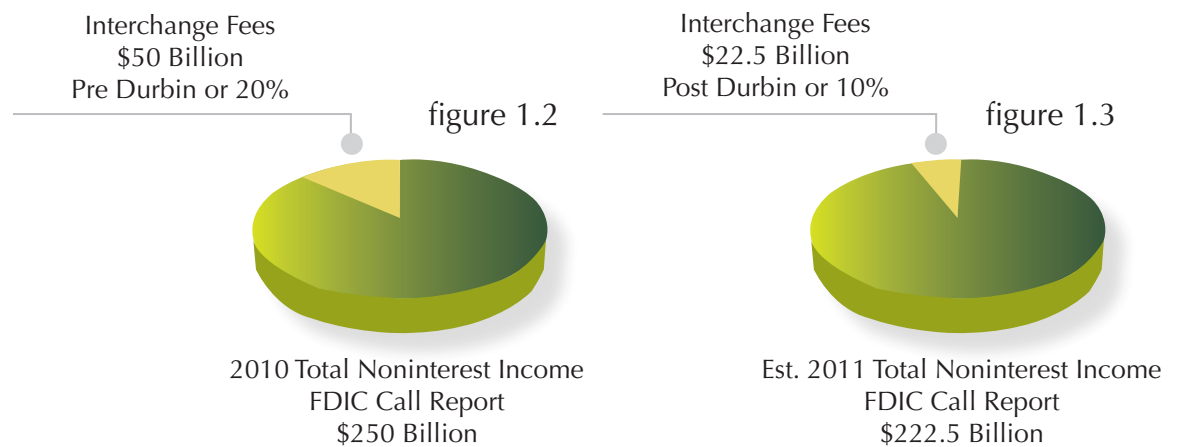
The Durbin Amendment is very complex, but the most noteworthy impact for financial institutions is capping the interchange fee that financial institutions receive at \$0.21 per debit card transaction — a decline of approximately 55% from present levels (average of \$0.44).



Note: There is an exemption to the Durbin Amendment that gives smaller financial institutions with less than \$10 billion in assets a pass on the fee cap.

# Durbin Amendment

With the National Retail Federation (NRF) estimating that card issuers collect more than \$50 billion a year from interchange fees, a 55% reduction will have a significant financial impact on the FI's service fee revenue streams. With total noninterest income at \$250 billion in 2010 (per the Q4 FDIC 2010 Call Report), the NRF's \$50 billion a year interchange fee estimate makes up 20% of the total non-interest income (see figure 1.2) for FIs. If the interchange fees decline 55% as a result of the Durbin Amendment, the interchange fee income would plummet to \$22.5 billion or 10% (see figure 1.3) of the total non-interest income for FIs.



Supporters of the amendment believe the pre-Durbin Amendment \$0.44 per transaction average is price gauging the merchants, and that the cost for the service including fraud protection is far less. Their theory is that the cap and the introduction of competition (eliminating the Visa & Mastercard duopoly) will ultimately result in lower prices for consumers.

Opponents of the bill argue that this cap will force banks and credit unions to take measures that would be a net negative for the consumers, such as eliminating debit card reward programs and charge consumer debit card usage in new and innovative ways. The opponents propose that such measures would negate any possible gains that would come from the Durbin Amendment.



# Regulation E Section 205

## Regulation E Section 205 (effective July 1, 2010)

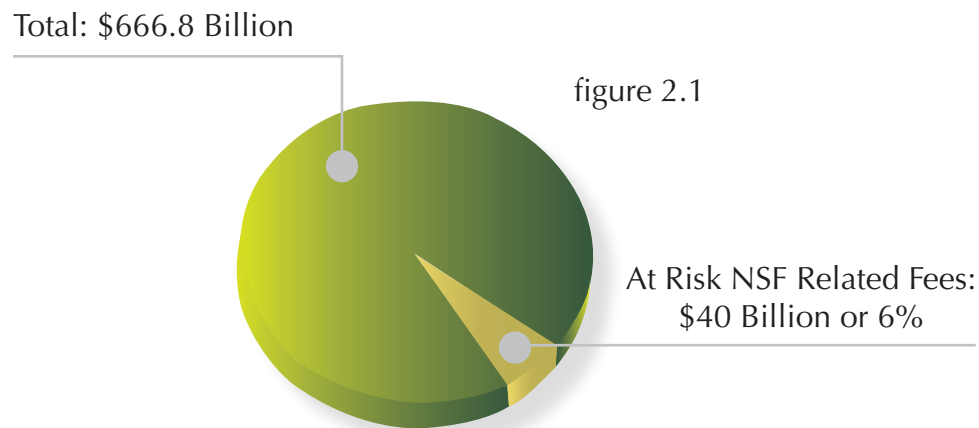


Regulation E Section 205 requires banks and credit unions to have their consumers give their permission to use the bank's nonsufficient fund automatic transfer services. Prior to this regulation change, consumers who over drafted their accounts would automatically be given the NSF service and would then receive a subsequent charge for the service.

The monetary impact of Regulation E Section 205 on financial institutions is the lost fee income associated with the required opt-in rules for FIs to be able to charge NSFs. The 2008 FDIC Study of Bank Overdraft Programs revealed that the majority (86.0 percent) of banks operated at least one formal overdraft program and the median fee assessed was \$27.

The study also showed that 74 percent of the service charges on deposit accounts were NSF-related fees, which accounted for roughly six percent of the total net operating revenues earned by the banks.

Net operating revenue (net interest income plus total noninterest income) was \$666.8 billion in 2010 (per the Q4 FDIC 2010 Call Report). If the assumption is made that there is a similar six percent portion of NSF related fees as the 2008 FDIC Study of Bank Overdraft Programs, then there is approximately \$40 billion in NSF income at risk (see figure 2.1).



**2010 Net Operating Revenue Insured Intuitions**

*What has happened since the Regulation E Section 205 implementation?*

We are now seeing the quantifiable impact of service charge income declining in deposit accounts – with a 20 percent drop in Q4 2010 over-the-year-earlier, as reported in the FDIC Quarterly Banking Profile Fourth Quarter 2010 (see figure 2.2). This was the second consecutive quarter that deposit account fees have declined by 20 percent or more from the prior year (FDIC).

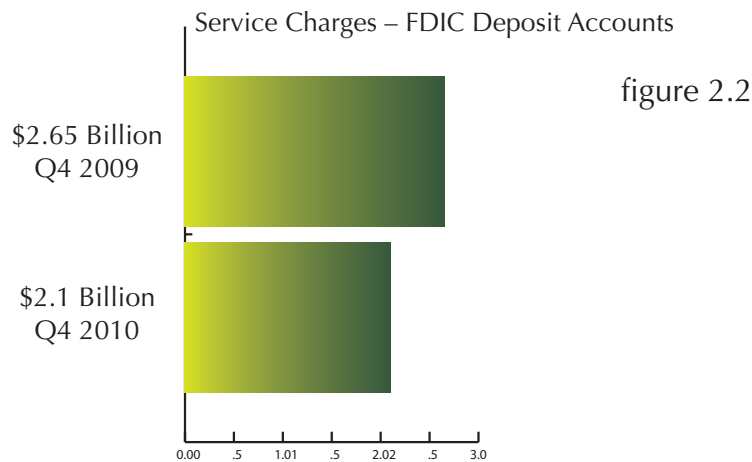


figure 2.2

If we assume the 2011 NSF related fees have a similar 20 percent drop as the service charges in figure 2.2, we would see a dramatic decline of \$8 billion (see figure 2.3). How will the industry respond?

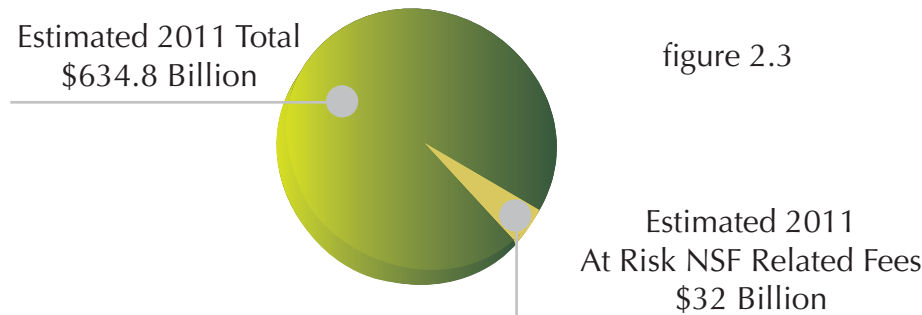


figure 2.3

**2011 Estimated Net Operating Revenue Insured Intuitions**

## Industry Reaction

Financial institutions are scrambling to make up for realized and anticipated reductions in revenue. They fear they will have to cut free consumer services, reduce operating expenses and/or increase fees in response to these increased profitability pressures. Specific actions taken by industry leaders include:

- Eliminating Debit Card Rewards Program: Wells Fargo, Chase, and SunTrust recently announced they are canceling their debit rewards program.
- Reducing Operating Expenses (such as reduction in excess front-line staff through workforce optimization like those provided by FMSI)
- Imposing fees on checking accounts and debit card usage.
- Investing in branch automation equipment, such as video teller machines and teller cash recyclers.
- Adjusting branch hours of operation, such as closing Saturday operations (See FMSI's [Hours of Operation Analysis Report](#)).



Conclusion

The fact that hundreds of insured financial institutions have failed in the last couple of years is a clear indication that the banking industry is in uncertain times. The recent economic recession coupled with challenging federal regulations, have forced banks and credit unions to turn-over every rock in an effort to do more with less. Any kind of operational inefficiency in this type of environment can no longer be tolerated. To maintain profitability, an organization must decrease its overall expenses and increase its revenues. Having a clear and concise strategy on how to handle federal regulations like the Durbin Amendment and Regulation E Section 205, is the critical first step toward a prosperous recovery.

An often overlooked area to decrease overall expenses is the reduction of staffing levels on the teller-line. As the data in the [FMSI Annual Teller Line Study](#) reveals, this cost continues to grow each year. During your Federal Regulation strategy meetings, look closely at your teller line workforce optimization. With the potential of \$30,000 per year per branch in excess labor costs, you may be leaving a very big rock unturned.



For over 20 years FMSI has assisted 600 plus nationwide financial institutions in optimizing their branch networks, through applying actionable business intelligence from the analysis of transaction data. The average FMSI client has saved \$30,000 per year, per branch. All FMSI clients receive extensive monthly reports including a ranking report that consists of their peer’s productivity metrics that are utilizing the FMSI solution – for comparison benchmarking purposes. In addition, they have a web-based scheduling engine that utilizes teller transaction data to prepare forecasts. Put simply, while using FMSI’s flagship product, The Teller Management System™, financial institutions of all sizes have been able to significantly reduce their operating expenses while maintaining great service levels.

See other [FMSI White Papers](#)

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**Sources Referenced in the Federal Regulations Impact White Paper:**

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